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TAGS: ECON ENRG EPET KCOR EIND IZ
SUBJECT: DCM VISITS KRG LEADERS, ADVANCING HYDROCARBON COMPROMISE AND RESUMPTION OF NEGOTIATIONS

Classified By: Ambassador Ryan Crocker for reasons 1.5 (b) and (d).

¶1. (C REL GBR) Summary. On May 14-15, the Deputy Chief of Mission and Economic Minister Counselor met with Kurdistan Regional Government (KRG) Prime Minister Nechirvan Barzani, KRG Minister of Natural Resources Ashti Hawrami, and the KRG Ministers of Interior and External Affairs to express US condolences regarding victims of recent attacks in the Kurdistan Region (KR), and discuss security and stalled hydrocarbon legislation. The DCM conveyed the increased sense of urgency in Washington to finalize a hydrocarbon deal, and the need for compromises that could move the legislation forward. Nechirvan asked for US support in training and equipping KR security forces. Recognizing the importance of the US relationship, Nechirvan understood the need to finalize draft national hydrocarbon legislation. He has agreed to come to Baghdad on Saturday, May 19 for initial bilateral meetings with political bloc leaders, followed by broader negotiations with GOI officials.

¶2. (C REL GBR) Summary continued. Nechirvan was firm that the KRG would not relinquish regional rights enshrined in the Iraqi Constitution, but told us he recognized the need to come to a conclusion in the negotiations. He also emphasized that no development in the Disputed Territories should be pursued until after the Article 140 referendum required by the Constitution, though he acknowledged that the KRG recently signed a contract for gas development in the Disputed Territories. The DCM elicited the views of the KRG officials and proposed possible compromise solutions on the revenue management law that we will work into a neutral draft to serve as a starting point for negotiations. By the end of the discussions, the Kurds told us that despite their initial insistence that field allocation annexes be appended to the framework hydrocarbon law approved by the Council of Ministers (CoM) on February 26, they would be supportive of a strategy to disengage the annexes from the framework hydrocarbon law in favor of appending them to the law reconstituting the Iraq National Oil Company (INOC). This approach would allow the framework law and revenue management law to advance to the Council of Representatives (CoR) prior to the INOC and Ministry of Oil (MinOil) reorganization laws. This could accelerate the delivery of two key pieces of the legislative package to the CoR, building momentum for immediate discussions of field allocations and principles for the INOC and MinOil laws.

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Interdependence of Security and Hydrocarbon Legislation
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¶3. (C REL GBR) The DCM expressed US condolences regarding victims of recent attacks in the KR, pointing out that the tragedy demonstrated that the KR is not an island in Iraq. KRG PM Barzani agreed that the KR is not impervious to the violence plaguing the rest of the country, and urgently stated that the KRG needs support from the US in training and

equipping KR security forces. The DCM reaffirmed the commitment of the US to the KRG, and suggested that the KRG PM discuss security issues with CG Petraeus when the KRG PM comes to Baghdad at the end of the week.

¶4. (C REL GBR) The DCM pointed out that there is an increased sense of urgency in Washington to finalize a hydrocarbon deal, and that the legislation has become a benchmark that will influence USG Iraq policy. Nechirvan stated that a quick withdrawal of US troops would be detrimental to Iraq and the KR, and acknowledged that moving forward with hydrocarbon legislation at this time is important.

New Compromises

¶5. (C REL GBR) Nechirvan told us that the KRG has already made concessions on the framework hydrocarbon law, and while he does not regret them, the KRG is not willing to compromise on revenue management law in ways that allow all revenue to be controlled by Baghdad. He said that the KRG is a successful government that needs financial independence--it would not be held hostage by the dysfunction of Baghdad. Nechirvan and Ashti also told us that the current field allocation annexes were "unacceptable," characterizing them as a back-door way to recentralize Iraq's oil sector by giving 93 percent of Iraq's resources to INOC. (Note: Review of the annexes shows that the 93 percent refers to the proportion of producing fields earmarked for INOC, not the proportion of all fields. The Kurds seem to be using the figure as a convenient way to reinforce the assertion that INOC is getting too much. End Note.) Ashti insisted that INOC would be incapable of handling most of these fields, and Nechirvan told us that their opposition is driven by

economics not politics. The Kurds assert that MinOil and some GOI officials believe that current oil production levels are adequate, but they disagree, citing additional revenue requirements to support reconstruction.

¶6. (C REL GBR) Ashti told us that the Constitution does not require that the KRG share revenue from new regional development, but they have agreed to share. He said, however, that the current allocations to INOC suggest that Iraq is not open for business, and the Kurds will therefore lose by aggressively developing their resources and sharing the revenue while production elsewhere remains at the status quo. The DCM responded that the US has set aside many of its views on the shape of an ideal hydrocarbon regime in favor of a regime that GOI and KRG officials can agree upon, and that the flexibility of KRG negotiators earlier in the process was appreciated. He pointed out, however, that the two sides seem to have been growing further apart rather than closer together over the last month and said that defiant talk--especially when the KRG still clearly has an economic interest in cooperating on the hydrocarbon issue--is not only unconstructive to the process, but has led to frustration among US officials. The DCM proposed that instead of seeking to cut federal authorities out of the revenue management process in a way that unhelpfully seems to divorce the KRG from Iraq, a compromise solution through checks and balances should be pursued.

¶7. (C REL GBR) Nechirvan repeated that the KRG would not set aside its Constitutional rights, but agreed that adequate assurances that the KR would efficiently and fairly get its share would be acceptable. Minister Ashti suggested reverting to a previous KRG suggestion that a panel of three signatories be established to unanimously authorize the disbursement of funds according to the premise of linked payments so that "no one gets paid unless everyone gets paid."

¶8. (C REL GBR) EconMinCouns commented that the most recent KRG draft revenue management law was very thorough and

professionally drafted, and the DCM asked if it would be better for negotiations if the US were to table a modified version of that draft that reflected the compromises discussed. (Note: The most recent version of the KRG draft is actually a modified version of a model revenue management law drafted by USG legal advisors and back-channeled to Deputy Prime Minister Barham Salih. Rather than pass the USG model to GOI drafters, Salih seems to have passed the model to KRG drafters who preserved most of the text, but replaced federal authorities with other entities. It is unclear if KRG officials are aware that US legal advisors were the original authors. End note.) The KRG PM welcomed the suggestion that the US table a draft as a starting point for discussion in Baghdad.

Challenges for Negotiations

¶9. (C REL GBR) As when the signatory body was first proposed in the Erbil meetings convened by former Ambassador Khalilzad in early February, Nechirvan continued to insist that all sects of Iraqi society must be represented, stating that the KRG must have a representative (vice a Kurdish GOI official). Nechirvan also asked the DCM why the US is opposed to the idea of sub-accounts for regions and governorates, with the KRG legal advisor interjecting that a sub-account was the KRG's constitutional right. The DCM said that constitutional arguments will take negotiations down the wrong road, and that there is no reason why a sound distribution mechanism should require more than one account.

¶10. (C REL GBR) On the topic of field allocation annexes, the DCM said that we are in general agreement that too many fields are going to INOC, but that the KRG must be flexible on their demand that no more than 50 percent go to INOC, suggesting that 75 percent might be more reasonable recognizing that mechanisms could be included that allowed flexibility over time to further reduce INOC coverage. Ashti said that INOC should get only the fields that it could handle in the near-term, with MinOil holding on to the rest to put them out for tender--perhaps giving preference to INOC or holding out on tendering for bigger fields to see if INOC is ready in a few years. He added that there should be accountability for the development of every field--if development plans established in the contracting phase were not adhered to, then the Federal Council on Oil and Gas could take the field away from the developer and re-tender it.

¶11. (C REL GBR) The DCM told Nechirvan that the KRG's economic arguments were good ones, but said that KRG

negotiators would need to be politically flexible. He also advised that they should identify where they could be flexible on reallocation of fields before the delegation arrives in Baghdad. Nechirvan and Ashti then agreed that it would be acceptable to de-link the annexes from the framework law entirely, adjusting the law to remove references to the annexes, and instead append them to the INOC law--as long as work was commenced on the INOC and MinOil reorganization laws as soon as the draft revenue management law was finalized. The DCM said that it would be important to establish the principles for the INOC and MinOil laws while the delegation was in Baghdad next week.

¶12. (C REL GBR) Nechirvan stated that the KRG remained firm that there should be no development in the Disputed Territories prior to the Article 140 referendum admitting, however, that the KRG had already breached that agreement (contained in the side letter accompanying the CoM-approved draft framework law) when it recently signed a gas development deal with UAE's Dana Gas. The PM citing the overiding need for electricity as the reason for this breach.

¶13. (C REL GBR) Comment. Prior to the arrival of the KRG delegation, Embassy has developed an engagement plan to

prepare key political bloc leaders for the presentation of the USG draft revenue management law, proposed compromises, and the need for their support. The objective is to wrap up negotiations on revenue management law and minor modifications of the framework law in time for the scheduled CoM meeting on Thursday, May 24, and urge the technical experts to begin work on the INOC and MinOil laws in the interim with the Energy Committee to engage as soon as the revenue-sharing law was completed.
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